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WHEN WILL MY TROUBLES END? THE LOSS IN PROGRESS DEFENSE IN PROGRESSIVE LOSS INSURANCE CASES

*Richard L. Antognini**

I. INTRODUCTION

Most general liability insurance policies only provide coverage when the claimant sustains bodily injury or property damage covered by the insured's policy while the policy is in force.¹ In the simplest of cases,

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1. Several insurance terms should be understood at the outset. "First party" insurance protects the insured when the insured's own person or property has been injured. "Casualty" or "liability" insurance protects the insured against claims made by third parties alleging that the insured's actions have injured them or damaged their property. *Garvey v. State Farm Fire & Casualty Co.*, 48 Cal. 3d 395, 399 n.2, 770 P.2d 704, 705 n.2, 257 Cal. Rptr. 292, 293 n.2 (1989). This Article primarily addresses issues arising in casualty or liability insurance.

One form of liability insurance is "comprehensive general liability" (CGL) insurance, which protects the insured against liability claims for bodily injury or property damage to third parties. Comprehensive liability policies arose in the 1940s and replaced policies that insured only against specifically enumerated hazards. Other types of comprehensive liability insurance policies in use throughout the insurance industry are comprehensive automobile liability policies, comprehensive personal liability policies, farmer's comprehensive personal liability policies, storekeeper's liability policies and hybrid liability policies. *PROPERTY AND LIABILITY INSURANCE HANDBOOK* 493-94 (John D. Long & Davis W. Gregg eds., 1965).

The insuring grant of a typical CGL policy states that the insurer will pay for third party bodily injury or property damage claims that the insured becomes legally obligated to pay due to an "occurrence" as defined in the policy. *Fireman's Fund Ins. Co. v. Aetna Casualty & Sur. Co.*, 223 Cal. App. 3d 1621, 1628, 273 Cal. Rptr. 431, 434 (1990). An occurrence is an accident, including exposure to conditions, which results in injury or damage not expected or intended by the insured during the policy period. *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034, 1040 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982).

CGL policies provide coverage only when the claimant sustains bodily injury or property damage while the policy is in force. *Abex Corp. v. Maryland Casualty Co.*, 790 F.2d 119, 121 (D.C. Cir. 1986). Typically, this requirement is found in a policy's definition of "bodily injury" or "property damage." For example, a standard definition of "property damage" is: "(1) physical injury to or destruction of tangible property *which occurs during the policy period*, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed if caused by an *occurrence during the policy period*." *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 1391 n.1, 253 Cal. Rptr. 277, 279 n.1 (1988) (emphasis added).

such as automobile accidents, the insured² and insurer can easily determine when the claimant sustained injury; injury is suffered when the accident occurs. However, in cases involving progressive losses where damage is not immediately apparent or detected and becomes worse over time,³ establishing the date of injury or loss is rarely so simple. Fixing that date has been a particularly troublesome and disputed issue in progressive loss cases involving asbestos,⁴ construction defects⁵ and pollu-

2. An insured is "[t]he person who obtains or is otherwise covered by insurance on his health, life, or property. The 'insured' in a policy is not limited to the insured named . . . but applies to anyone who is insured under the policy." BLACK'S LAW DICTIONARY 808 (6th ed. 1990).

3. See, e.g., *Prudential-LMI Commercial Ins. v. Superior Court*, 51 Cal. 3d 674, 693, 798 P.2d 1230, 1242-43, 274 Cal. Rptr. 387, 399 (1990). In that case, the insurer had provided first party property coverage for the owners of an apartment building in San Diego, California. *Id.* at 679-80, 798 P.2d at 1233, 274 Cal. Rptr. at 390. Soil subsidence had caused large cracks in the building's foundation and floor slabs over several years, but carpeting had hidden the cracks. *Id.* at 680-81, 798 P.2d at 1233-34, 274 Cal. Rptr. at 390-91.

4. See, e.g., *Keene Corp.*, 667 F.2d 1034. In cases involving asbestos-related disease, inhalation—the occurrence that causes the injury—takes place substantially before manifestation of the ultimate injury, whether asbestosis, mesothelioma or lung cancer. *Id.* at 1040. Inhalation may continue over several policy periods, the disease may develop during subsequent policy periods, and manifestation of the ultimate injury may occur in yet another policy period. *Id.* In such cases, different insurers are likely to insure the risk at different points in the development of each plaintiff's disease. *Id.*

Courts consider at least two theories in determining when coverage is triggered. The exposure theory states that coverage is triggered at the time or times the claimant was exposed to the asbestos-containing product. *Eagle-Picher Indus. v. Liberty Mut. Ins. Co.*, 523 F. Supp. 110, 114 (D. Mass. 1981). The manifestation theory states that coverage is triggered when the asbestos-related disease first manifests itself by discoverable signs or symptoms. *Id.* The theory chosen by a court is important because manifestation of an asbestos-related disease can occur as long as twenty years after the initial exposure. *Id.* at 115. The court in *Keene Corp.* rejected both the manifestation and exposure theories as the sole basis of liability and held that coverage was triggered by both exposure and manifestation. 667 F.2d at 1041.

5. See, e.g., *Fireman's Fund Ins. Co. v. Aetna Casualty & Sur. Co.*, 223 Cal. App. 3d 1621, 1630, 273 Cal. Rptr. 431, 435 (1990) (involving coverage for "patching" work on hotel in San Diego). "Patching" is the process of using a patching compound to fill holes in walls. The compound failed and cracked and spalled off the walls. *Id.* at 1624, 273 Cal. Rptr. at 432; see also *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 253 Cal. Rptr. 277 (1988) (involving misapplication of concrete and plaster to hotel insured under first party property policy).

Since latent construction defects may not manifest themselves until a later successive policy period, the obligation to cover the loss can potentially shift to a different insurer. *Id.* at 1390, 253 Cal. Rptr. at 278. For example, in *Home Insurance Co.* the claim involved damage to the Hotel del Coronado in San Diego caused by the application of concrete and plaster to the hotel. *Id.* The key to imposing liability on a specific carrier was whether there had been an occurrence within the policy period. *Id.* at 1392-93, 253 Cal. Rptr. at 280. An occurrence was defined in the policy as "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the Insured." *Id.* at 1390 n.1, 253 Cal. Rptr. at 278 n.1. Thus, to determine whether there had been an occurrence within the meaning of the policy, fixing the date of injury was critical.

tion⁶ claims because they frequently involve injuries that become progressively worse over time, while remaining undetected for years.⁷ Progressive losses can also arise in product liability claims⁸ and even in claims for patent infringement.⁹ Because most general liability policies only cover personal injury or property damage that occurs *during* the policy period, fixing the date of injury is critical.

Courts have struggled for years with the problem of fixing dates of injury in progressive loss cases to determine which insurer, if any, is required to pay for the loss.¹⁰ While courts usually attempt to determine

6. See, e.g., *Industrial Steel Container Co. v. Fireman's Fund Ins. Co.*, 399 N.W.2d 156 (Minn. Ct. App. 1987). In *Industrial Steel Container Co.* a company disposed of toxic waste in a landfill during the 1970s. *Id.* at 157-58. Over the years the surrounding soil and ground-water absorbed the toxic chemicals. *Id.* at 158. The defendant insurance companies fought any liability for the toxic chemical clean-up arguing that there had been no occurrence of property damage yet. *Id.* They contended that because the toxic waste was added to the landfill only in the early 1970s, and their policies were in effect from 1982 to 1984, there could not have been an occurrence of property damage caused by the toxic waste during the periods of their coverage. *Id.* at 157-58.

Although the contamination initially manifested itself before these policies became effective, the leakage continued during these policy periods, resulting in continued manifestation of actual injury. *Id.* at 159-60. The court held that there can be damage with more than one manifestation in cases of exposure to toxic substances. *Id.* at 159. The court, therefore, rejected the argument that there can be only one occurrence in a case where damage results from continuous or repeated exposure to conditions. *Id.* at 159-60.

7. See, e.g., *Gruol Constr. Co. v. Insurance Co. of N. Am.*, 524 P.2d 427 (Wash. Ct. App. 1974). In this progressive loss case, a building owner sued the building's general contractor after finding dry rot in the building. *Id.* at 429. The dry rot was caused by dirt piled against the box sills of the building when it was built in 1964. *Id.* The owner sued for damage when the dry rot was detected four years later. *Id.*

8. See, e.g., *Uniroyal Inc. v. Home Ins. Co.*, 707 F. Supp. 1368 (E.D.N.Y. 1988). Agent Orange was an extremely toxic herbicide used by American military personnel during the Vietnam War to clear foliage from the Vietnamese countryside. *Id.* at 1370. Uniroyal manufactured and delivered Agent Orange to the United States military from 1966 to 1968 and discontinued any further activity with the herbicides or their application. *Id.* Uniroyal purchased five consecutive CGL policies which covered both the period during the manufacture and sale of Agent Orange, as well as all later periods during which military personnel filed products liability lawsuits for wrongful death and personal injuries. *Id.* at 1371. The court considered the issue of whether the continuous and repeated exposure to Agent Orange over two years constituted an occurrence under the policy. *Id.* at 1379-80. The court held that the single occurrence, resulting in later progressive losses to military personnel, was the manufacture of Agent Orange. *Id.* at 1383.

9. See, e.g., *Intex Plastics Sales Co. v. United Nat'l Ins. Co.*, 18 U.S.P.Q.2d (BNA) 1567 (C.D. Cal. 1990). The insured engaged in allegedly infringing activity in the sale of waterbed mattresses throughout the policy period covered by three different insurers. *Id.* at 1568. The court held that the insurance companies owed a duty to defend the insured even though the infringement claims were not made until years after the last policy had expired. *Id.* at 1570.

10. *Porter v. American Optical Corp.*, 641 F.2d 1128, 1145 (5th Cir. Apr.) (discussing whether insurance policy covered injuries at time of manifestation of injury or time of exposure), *cert. denied*, 454 U.S. 1109 (1981).

when liability coverage begins,¹¹ they sometimes struggle to determine when liability coverage ends.¹² Recently, however, courts have used a set of old and presumably well-established principles of insurance law to fix the termination of coverage.¹³ Such principles as the doctrine of "fortuity" or "known loss" are embodied in the "loss in progress" doctrine.¹⁴ The loss in progress doctrine states that insurance only covers losses that are unknown or contingent at the time a policy is issued.¹⁵ Insurance carriers raise the loss in progress doctrine as a defense when an insured claims coverage against its comprehensive general liability (CGL) or first party insurance policy.¹⁶ The loss in progress defense asserts that a loss is not covered because the loss was known or was known to be inevitable when the policy was issued.¹⁷

The loss in progress doctrine raises three related issues. First, does the doctrine apply if the loss was inevitable at the time the policy was issued or only if the insured knew of the loss at that time?¹⁸ Second, if the insured's knowledge of a loss at a policy's issuance is required, must the insured have had actual knowledge of the loss or is the knowledge of a reasonable insured sufficient?¹⁹ Third, will the doctrine apply if the insured merely knows of a loss that *may* later give rise to a claim against the insured, or is the insured required to know of existing claims arising from the loss?²⁰

This Article analyzes the theoretical and practical bases for the loss

11. *E.g.*, *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982). The court in *Keene Corp.* stated that it must determine when coverage liability begins because "[n]either the case law nor the terms of the policies lead us directly to a resolution of the coverage issues raised in this case. Unfortunately, the insurance companies failed to develop policy language that would directly address the full complexity" *Id.* at 1041 (footnote omitted); *see also* *Dow Chem. Co. v. Associated Indem. Corp.*, 724 F. Supp. 474, 477-79 (E.D. Mich. 1989) (applying Michigan law) (discussing competing theories of liability commencement).

12. *Snapp v. State Farm Fire & Casualty Co.*, 206 Cal. App. 2d 827, 831, 24 Cal. Rptr. 44, 46 (1962).

13. *E.g.*, *Prudential-LMI Commercial Ins. v. Superior Court*, 51 Cal. 3d 674, 682-83, 798 P.2d 1230, 1235, 274 Cal. Rptr. 387, 392-93 (1990); *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 1393, 253 Cal. Rptr. 277, 280 (1988).

14. This Article will refer to these doctrines collectively as the "loss in progress" doctrine.

15. *Standard Structural Steel Co. v. Bethlehem Steel Corp.*, 597 F. Supp. 164, 191-92 (D. Conn. 1984); *Home Ins. Co.*, 205 Cal. App. 3d at 1395, 253 Cal. Rptr. at 281-82.

16. *See, e.g.*, *Insurance Co. of N. Am. v. United States Gypsum Co.*, 870 F.2d 148 (4th Cir. 1989) (involving first party claim); *Chu v. Canadian Indem. Co.*, 224 Cal. App. 3d 86, 274 Cal. Rptr. 20 (1990) (involving third party claim).

17. "Known or inevitable loss" is a loss that is certain to occur. *United States Gypsum Co.*, 870 F.2d at 152.

18. *See infra* notes 66-93 and accompanying text.

19. *See infra* notes 94-152 and accompanying text.

20. *See infra* notes 153-91 and accompanying text.

in progress doctrine and explores how it works in practice. This Article also considers the practical effect of the loss in progress doctrine and proposes a theory for applying that doctrine: once an insured knows of a certain loss, although not necessarily the extent of the damages or number of claims, the insured should no longer be able to obtain insurance for that loss. However, until the time the insured knows of the loss, the loss should remain contingent and fully insurable. Finally, this Article examines the loss in progress doctrine from a national perspective, and advocates that these principles be applied nationally.²¹

II. CURRENT APPLICATION OF THE LOSS IN PROGRESS DOCTRINE

A. *The Loss in Progress Doctrine and the Principle of Contingent or Unknown Loss*

1. Development of the doctrine

All insurance is based on the principle that losses must be unknown or contingent, rather than certain, at the time a policy is issued.²² This principle, described as "fortuity," lies at the heart of the loss in progress doctrine.²³ This basic principle of contingent or unknown losses is embodied in statutory and case law,²⁴ as well as in the original Restatement of Contracts²⁵ and the Second Restatement of Contracts.²⁶

21. Nonetheless, California cases will dominate the discussion of some issues because the California courts have been particularly active in the development of the loss in progress doctrine. For example, a California case, *Chu v. Canadian Indemnity Co.*, 224 Cal. App. 3d 86, 274 Cal. Rptr. 20 (1990), is the only case in the country to examine the issue of whether notice to the insured of one loss is notice of other but unrelated losses. See *infra* notes 192-97 and accompanying text.

22. See ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* § 1.3(a) (1988) (discussing concept of risk). The authors state:

Risk is an abstract concept . . . [S]ince only some portion of the relevant facts that affect any endeavor can ever be known, predictions about the occurrence of a potential loss inevitably are based partly on estimates or guesswork. This speculative aspect is generally understood as the "element of risk" in an insurance transaction. Recognition of the risk element is essential to developing techniques for managing the unknown and unknowable, and the transfer of the element of risk in regard to the unknown is the characteristic that is almost invariably associated with any conceptualization of insurance.

Id.

23. See generally Stephen A. Cozen & Richard C. Bennett, *Fortuity: The Unnamed Exclusion*, 20 FORUM 222 (1985) ("[E]very 'all risk' contract of insurance contains an unnamed exclusion—the loss must be *fortuitous* in nature.").

24. See *infra* notes 41-61 and accompanying text.

25. RESTATEMENT OF CONTRACTS § 291 cmt. a (1932). The Restatement of Contracts states:

A fortuitous event . . . is an event which so far as the parties to the contract are aware, is dependent on chance. It may be beyond the power of any human being to bring the event to pass; it may be within the control of third persons; it may even be a

The concept of fortuity (or unknown or contingent losses)²⁷ as a limit on insurance coverage originated in the area of marine insurance shortly after World War I.²⁸ The earliest cases held that a loss was not fortuitous if a latent defect in property made damage to the property inevitable, regardless of whether the insured knew of the latent defect.²⁹ Those courts stressed that the purpose of the fortuity doctrine was to prevent fraud in the procurement of insurance policies.³⁰ These decisions were largely a reaction to insureds seeking marine insurance after they knew a loss had taken place, or that a loss was inevitable.³¹

past event, such as the loss of a vessel, provided that the fact is unknown to the parties.

Id., cited with approval in *Compagnie des Bauxites v. Insurance Co. of N. Am.*, 724 F.2d 369, 372 (3d Cir. 1983).

26. RESTATEMENT (SECOND) OF CONTRACTS § 379 cmt. a (1981). The Second Restatement of Contracts states:

An aleatory contract is one in which at least one party is under a duty that is conditional on the occurrence of an event that, so far as the parties to the contract are aware, is dependent on chance. Its occurrence may be within the control of third persons or beyond the control of any person. The event may have already occurred, as long as that fact is unknown to the parties.

Id.; see *Employers Casualty Co. v. Holm*, 393 S.W.2d 363, 368 (Tex. Civ. App. 1965) (holding insurer liable for water damage due to leaking shower stall even though stall was constructed without shower pan; damage was fortuitous and, therefore, covered under "all risks of physical loss" insurance policy because neither party contemplated defect); see also *Essex House v. St. Paul Fire & Marine Ins. Co.*, 404 F. Supp. 978, 989 (S.D. Ohio 1975) (holding insurer liable where loss resulted from inherent defect because when policy issued insured was uncertain when damage, if any, would occur).

27. See *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 1395 n.4, 253 Cal. Rptr. 277, 282 n.4 (1988) (definition of terms); RESTATEMENT OF CONTRACTS § 291 cmt. a (1931) (fortuitous losses are dependent on chance insofar as parties to contract are aware).

28. See, e.g., *Mellon v. Federal Ins. Co.*, 14 F.2d 997, 1000-02 (S.D.N.Y. 1926) (holding boiler explosion on ship not fortuitous because court could not rule out normal wear and tear as possible cause, and because test procedure during which boiler exploded was deliberate act); *British & Foreign Marine Ins. Co. v. Gaunt*, 2 App. Cas. 41 (H.L. 1921) (holding water damage to wool carried on ship's deck fortuitous where damage would have been avoided by shipper's proper use of tarpaulins); *Hutchins Bros. v. Royal Exch. Assurance Corp.*, 2 K.B. 398 (K.B. 1911) (holding latent defect of ship's stern frame not recoverable under insurance policy where defect existed prior to policy issuance).

29. *Mellon*, 14 F.2d at 1002-03; see also *Insurance Co. of N. Am. v. United States Gypsum Co.*, 678 F. Supp. 138, 141 (W.D. Va. 1988), *aff'd*, 870 F.2d 148 (4th Cir. 1989) (holding insured's loss due to collapse of earth beneath gypsum processing plant fortuitous regardless of insured's knowledge of extensive mining and prior instances of subsidence in area); *Chute v. North River Ins. Co.*, 214 N.W. 473 (Minn. 1927) (holding opal cracked during shipping as result of inherent defect not covered under policy that established indemnity against loss or damage from fortuitous circumstances).

30. *United States Gypsum Co.*, 678 F. Supp. at 141 ("The underlying principle of the [fortuity] doctrine is public policy: it would encourage fraud to allow recovery on an insurance loss which is certain to occur.") (citing *Compagnie des Bauxites v. Insurance Co. of N. Am.*, 554 F. Supp. 1080, 1085 (W.D. Pa.), *rev'd*, 724 F.2d 369 (3d Cir. 1983) (withholding judgment on public policy issue)).

31. *Mellon*, 14 F.2d at 1001-03.

As the fortuity doctrine spread to all areas of insurance, courts began to hold that a loss would be covered even if a defect in the property existing at the time a policy was issued made that loss inevitable, as long as the insured was unaware of the defect.³² Courts expressly relied on the idea of risk or contingent loss, finding that insurance should only cover losses that are unknown to the insured at the time a policy is issued and should not cover losses the insured expected or intended.³³ Thus, an inevitable but unknown loss should be covered.³⁴

The loss in progress doctrine is but another statement of this rule.³⁵ A loss is in progress if an insured knows about the loss when the policy is issued.³⁶ If a loss is no longer contingent or unknown, the insurance carrier is not insuring against a risk, but against a certainty.³⁷

The requirement that a loss be contingent in order to be covered by insurance is frequently embodied in a statute. In California, the contingent loss principle is expressed in two statutes, sections 22 and 250 of the California Insurance Code.³⁸ Section 22 states: "Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a *contingent* or *unknown* event."³⁹ Section 250 limits insurance coverage to "any *contingent* or *unknown* event, whether past or future, which may damnify a person having an insurable interest, or create a liability against him [or her]."⁴⁰

Further, states such as Alabama,⁴¹ Louisiana,⁴² Maryland⁴³ and

32. *Miller's Mut. Fire Ins. Co. v. Murrell*, 362 S.W.2d 868, 869-70 (Tex. Civ. App. 1962).

33. *Intermetal Mexicana v. Insurance Co. of N. Am.*, 866 F.2d 71, 77-78 (3d Cir. 1989) (applying Pennsylvania law) (holding taking of equipment pursuant to court order was to be expected and therefore not fortuitous in context of commercial debtor-creditor relationship); *United States Gypsum Co.*, 678 F. Supp. at 142-43 (holding collapse of manufacturing plant fortuitous where firm had invested 12 million dollars to modernize).

34. *United States Gypsum Co.*, 678 F. Supp. at 141-42; *Miller's Mut. Fire Ins. Co.*, 362 S.W.2d at 870.

35. Evidently, the term "loss in progress" originated with a California case. *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 1395, 253 Cal. Rptr. 277, 281-82 (1988).

36. *Prudential-LMI Commercial Ins. v. Superior Court*, 51 Cal. 3d 674, 695 n.7, 798 P.2d 1230, 1244 n.7, 274 Cal. Rptr. 389, 401 n.7 (1990) (holding loss in progress codifies fundamental principle of insurance law that insurer cannot insure against loss known or apparent to insured) (citing *Bartholomew v. Appalachian Ins. Co.*, 655 F.2d 27, 28-29 (1st Cir. 1981)); *Home Ins. Co.*, 205 Cal. App. 3d at 1395, 253 Cal. Rptr. at 282 (holding insurance may insure only against contingent or unknown risks).

37. *British & Foreign Marine Ins. Co. v. Gaunt*, 2 App. Cas. 41, 57 (H.L. 1921).

38. CAL. INS. CODE §§ 22, 250 (West 1972).

39. *Id.* § 22 (emphasis added); see also *Intermetal Mexicana v. Insurance Co. of N. Am.*, 866 F.2d 71, 77-78 (3d Cir. 1989) (holding that taking of equipment as result of valid court order is not fortuitous event).

40. CAL. INS. CODE § 250 (West 1972) (emphasis added).

41. ALA. CODE § 27-1-2(1) (1986) (Insurance is "[a] contract whereby one undertakes to

New York⁴⁴ also have enacted statutes that require an insurable loss to be fortuitous. Other states recognize the rule of contingent loss or risk in case law.⁴⁵ For example, in *Altena v. United Fire & Casualty Co.*,⁴⁶ the Iowa Supreme Court concluded that public policy limits insurance to fortuitous losses only "and generally provides 'no coverage for intentional loss.'"⁴⁷ The court refused to find coverage for a tenant's claims against her landlord for sexual molestation because, in part, it believed insurance should cover *accidental* or unknown losses.⁴⁸ Coverage for an intentional loss such as this would be against the public policy of deterring anti-social conduct.⁴⁹ In *Bartholomew v. Appalachian Insurance Co.*,⁵⁰ the First Circuit Court of Appeals applied Rhode Island law and found that "[t]he concept of insurance is that the parties, in effect, wager against the occurrence or non-occurrence of a specified event; the carrier insures against a risk, not a certainty."⁵¹ Other states that recognize or whose courts imply that a loss must be contingent include: Alabama,⁵²

indemnify another or pay or provide a specified amount or benefit upon determinable contingencies.").

42. LA. REV. STAT. ANN. § 22:5(1)(a) (West 1959 & Supp. 1991) (" 'Insurance' is a contract whereby one undertakes to indemnify another or pay a specified amount upon determinable contingencies.").

43. MD. ANN. CODE art. 48A, § 2 (1957) (Insurance is a "contract whereby one undertakes to indemnify another or pay or provide a specified or determinable amount or benefit upon determinable contingencies.").

44. N.Y. INS. LAW § 1101(a)(1) (McKinney 1985) (Insurance contract is "any agreement or other transaction whereby one party, the 'insurer', is obligated to confer benefit of pecuniary value upon another party, the 'insured' or 'beneficiary', dependent upon the happening of a fortuitous event.").

45. See *infra* notes 46-61 and accompanying text.

46. 422 N.W.2d 485 (Iowa 1988).

47. *Id.* at 487 (quoting ROBERT E. KEETON, BASIC TEXT ON INSURANCE LAW § 5.4(b), at 291 (1971)).

48. *Id.* at 490.

49. *Id.* at 490-91. Some courts interpret fortuitous as analogous to "accidental." See, e.g., *Insurance Co. of N. Am. v. United States Gypsum Co.*, 678 F. Supp. 138, 141 (W.D. Va. 1988), *aff'd*, 870 F.2d 148 (4th Cir. 1989). Some courts interpret fortuitous to mean "not deliberate." *Mellon v. Federal Ins. Co.*, 14 F.2d 997, 1001-02 (S.D.N.Y. 1926).

50. 655 F.2d 27 (1st Cir. 1980). The insured sold defective car-washing equipment to the plaintiff who complained about the defects and sued the insured before the insurance policy was issued. *Id.* at 28. The First Circuit found that the loss was not insurable because the occurrence giving rise to liability occurred before the policy took effect. *Id.* at 28-29.

51. *Id.* at 29.

52. *United States Fidelity & Guar. Co. v. Bonitz Insulation Co.*, 424 So. 2d 569, 572 (Ala. 1982). Bonitz installed a roof that leaked for several years prior to Bonitz obtaining insurance. *Id.* at 571. Because Bonitz had been aware of the leaks before the policy was issued the damage was not unusual or unforeseen and therefore the Alabama Supreme Court concluded no coverage existed. *Id.* at 572.

53. *Mattis v. State Farm Fire & Casualty Co.*, 454 N.E.2d 1156, 1163 (Ill. App. Ct. 1983). State Farm argued that the defective design of a home made subsequent settlement damage

Illinois,⁵³ Louisiana,⁵⁴ Minnesota,⁵⁵ Missouri,⁵⁶ New Jersey,⁵⁷ Ohio,⁵⁸ Pennsylvania,⁵⁹ Texas⁶⁰ and West Virginia.⁶¹

inevitable and thus a loss in progress. *Id.* at 1164. The Illinois Appellate Court disagreed and upheld coverage because an inevitable loss may not be the same as a loss in progress. *Id.* The court used a proximate cause test which concluded the loss was a combination of natural conditions and defective design. *Id.* But for this interaction and contribution of causes the event may not have been inevitable. *Id.* It was this point that made the loss fortuitous and, therefore, an insurable risk. *Id.*

54. *Summers v. Harris*, 573 F.2d 869, 872 (5th Cir. 1978) (applying Louisiana law). The insured applied for and was issued flood insurance when flood waters were within a few feet of his house. *Id.* at 870-71. The court concluded that no coverage existed because the loss was in progress when the policy was issued. *Id.* at 871-72.

55. *Bituminous Casualty Corp. v. Bartlett*, 240 N.W.2d 310, 313 (Minn. 1976), *overruled on other grounds by Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389 (Minn. 1979). The court held that a contractor's intentional failure to conform to building specifications was not an occurrence covered by the CGL policy. *Id.* at 313-14. The court said that a CGL policy is designed to protect the insured from fortuitous losses, which can include losses due to carelessness, but not intentional or reckless acts. *Id.* at 313.

56. *United States v. Conservation Chem. Co.*, 653 F. Supp. 152, 180-81 (W.D. Mo. 1986) (applying Missouri law). The insured sought coverage for an environmental clean-up suit, even though the policies were issued after the lawsuit had been filed. *Id.* at 162-64. The district court held that public policy barred coverage for litigation that had started before the policy went into effect because the lawsuit was a pre-existing claim and there was no unequivocal understanding that such claims were to be covered. *Id.* at 179-81.

57. *Gloucester Township v. Maryland Casualty Co.*, 668 F. Supp. 394, 402-03 (D.N.J. 1987) (applying New Jersey law). A federal district court refused to impose coverage on an insurer that issued a policy after the insured had been sued for environmental damage. *Id.* at 403.

58. *Essex House v. St. Paul Fire & Marine Ins. Co.*, 404 F. Supp. 978, 989 (S.D. Ohio 1975) (applying Ohio law). The carrier contended that at the time the insured applied for its policy it was inevitable that the brick facing on the insured building would collapse, as it eventually did. *Id.* at 987. The court disagreed, noting that even the carrier's own experts could not testify that at the policy's inception it was certain that a loss would occur. *Id.* at 985. The court stressed that "a fortuitous event is a loss arising from a defect unknown to the parties" when they enter into the insurance contract. *Id.* at 990 (citing *Employers Casualty v. Holm*, 393 S.W.2d 363 (Tex. Civ. App. 1965)).

59. *D'Auria v. Zurich Ins. Co.*, 507 A.2d 857, 862 (Pa. Super. Ct. 1986). The Pennsylvania appellate court declined to find coverage for a malpractice action against a doctor. *Id.* at 858. The plaintiff had suffered renal failure in 1979, but signs of deterioration in his renal system had been apparent to the doctor in 1963. *Id.* The insurance policies at issue were in effect between 1973 and 1982. *Id.* The court concluded that "as a matter of policy, the three appellee insurance companies should not be forced to defend for an injury which was, at least in embryonic form, reasonably apparent thirteen years before any of them undertook to provide occurrence coverage." *Id.* at 862. The court did not want to force the insurer to "insure against something which has already begun." *Id.* (quoting *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 63 (3d Cir. 1982)).

60. *Burch v. Commonwealth County Mut. Ins. Co.*, 450 S.W.2d 838 (Tex. 1970). The Texas Supreme Court held that collision insurance was effective even though the loss occurred prior to the issuance of the policy, provided that neither the applicant nor the insurer knew of the loss when the contract was made. *Id.* at 841.

61. *Insurance Co. of N. Am. v. United States Gypsum Co.*, 870 F.2d 148, 151-52 (4th Cir. 1989) (applying Virginia law), *aff'g* 678 F. Supp. 138 (W.D. Va. 1988). The insured sought

Although the principle that insurance can be provided only against contingent losses has found widespread acceptance, it raises three troubling questions when applied to specific claims. First, is a loss in progress and thus not covered by a policy, if the loss was merely inevitable when the insurance contract was signed?⁶² Or, is the loss in progress only if the insured has knowledge of the loss when the policy was issued?⁶³ Second, if the loss in progress doctrine requires knowledge of the loss at the time of policy issuance to bar a claim, must the insured have actual knowledge of the loss or is the knowledge of a reasonable insured sufficient?⁶⁴ Third, to preclude coverage under the loss in progress doctrine, must the insurance carrier show the insured merely had knowledge of a loss that *may* later give rise to a claim, or must the insured know of specific claims actually made as a result of the loss?⁶⁵

2. Inevitable loss versus insured's knowledge of loss

Insurance carriers have argued that a loss is in progress when it is inevitable that the loss will take place, even if the insured is not aware of the problem when the policy is issued. The carrier made this argument in *Insurance Co. of North America v. United States Gypsum Co.*⁶⁶ In that case, the insured sought benefits under a property insurance policy after soil subsidence had damaged its gypsum processing plant.⁶⁷ The carrier produced expert testimony that soil subsidence was inevitable at the time the insured applied for the policy,⁶⁸ but presented no evidence that the insured was aware that such damage was inevitable.⁶⁹ The district court rejected the proposition that a loss in progress could be established by inevitable damage alone, without any knowledge by the insured.⁷⁰

The court in *United States Gypsum Co.* observed that earlier cases had held losses caused by inherent defects in insured property were non-

coverage for property loss it sustained after massive sinkholes appeared at one of its manufacturing plants. *Id.* at 151. For over three decades, much smaller sinkholes had occurred on the property. *Id.* The Fourth Circuit upheld a trial court judgment that the loss was nonetheless fortuitous. *Id.* at 151-53.

62. See *infra* notes 66-93 and accompanying text.

63. See *infra* notes 66-93 and accompanying text.

64. See *infra* notes 94-152 and accompanying text.

65. See *infra* notes 153-91 and accompanying text.

66. 678 F. Supp. 138 (W.D. Va. 1988) (applying Virginia law), *aff'd*, 870 F.2d 148 (4th Cir. 1989). After the jury had returned a verdict in favor of coverage, the carrier made a motion for judgment notwithstanding the verdict. *Id.* at 139. The court denied the motion because it found the loss was fortuitous. *Id.* at 144.

67. *Id.* at 139-40.

68. *Id.* at 143.

69. *Id.*

70. *Id.* at 141-42.

fortuitous and thus not insurable.⁷¹ The court, however, chose to use the more recent standard for fortuity: as long as the insured is unaware of the inherent defect, the loss is fortuitous.⁷² Under this approach, an insured may recover for a loss even if the insured was negligent.⁷³ Even though the insured's employees were grossly negligent in failing to detect defects, the loss was fortuitous and thus covered because the carrier could not prove that the insured had been aware of the inevitable damage.⁷⁴

The California Supreme Court reached a similar conclusion twenty-five years earlier in *Sabella v. Wisler*.⁷⁵ In *Sabella* the insurance carrier argued that its homeowner's policy did not cover a loss caused by a broken sewage pipe, because subsidence damage to the home was inevitable at the time the policy was issued.⁷⁶ The court in *Sabella* rejected the insurer's argument that inevitability was the sole standard for a fortuitous loss.⁷⁷

In another case applying California law, *Kilroy Industries v. United Pacific Insurance Co.*,⁷⁸ Kilroy sought business interruption coverage⁷⁹ under its property policy when numerous defects in a building it owned forced its tenants to vacate.⁸⁰ The carrier contended that the loss was inevitable and thus not fortuitous because the defects were based on faulty workmanship done at the time of construction, which was prior to the issuance of the policy.⁸¹ The district court held that the carrier owed coverage because Kilroy had been unaware of the defects when it applied

71. *Id.* at 141 (citing *Mellon v. Federal Ins. Co.*, 14 F.2d 997, 1004 (S.D.N.Y. 1926); *British & Foreign Marine Ins. Co. v. Gaunt*, 2 App. Cas. 41, 57 (H.L. 1921)).

72. *Id.* at 142.

73. *Id.*

74. *Id.* at 144.

75. 59 Cal. 2d 21, 377 P.2d 889, 27 Cal. Rptr. 689 (1963).

76. *Id.* at 34, 377 P.2d at 897, 27 Cal. Rptr. at 697.

77. *Id.*

"[A]fter any movement of land has occurred it might be said to have been 'inevitable' with semantic correctness, but such 'inevitability' does not alter the fact that at the time the contract of insurance was entered into, the event was only a *contingency* or *risk* that might or might not occur within the term of the policy." Moreover, the breaking of the sewer pipe and consequent induction of quantities of waste water into the improperly compacted fill may be viewed as an unanticipated external event or casualty, operating to trigger the greatly accelerated action of possibly inherent vices.

Id. (quoting *Snapp v. State Farm Fire & Casualty Co.*, 206 Cal. App. 2d 827, 830, 24 Cal. Rptr. 44, 45 (1962)).

78. 608 F. Supp. 847 (C.D. Cal. 1985).

79. Business interruption insurance indemnifies a business for lost income during the time it takes to "restore property damaged by an insured peril to a useful condition." EMMET J. VAUGHAN, *FUNDAMENTALS OF RISK AND INSURANCE* 518 (3d ed. 1982).

80. *Kilroy Indus.*, 608 F. Supp. at 849.

81. *Id.* at 857.

for the policy.⁸² It then held that, as a matter of law, plaintiff's loss was fortuitous because the plaintiff had no knowledge of the defects.⁸³

These courts are correct in rejecting the inevitable loss concept as a test for determining if a loss is fortuitous. An inevitability standard encourages courts to apply a hindsight test in defining fortuity, when fortuity should be judged by the insured's knowledge at the time a policy became effective.⁸⁴ Further, most insurance underwriters have assumed that inevitability is not the test for fortuity.⁸⁵ Rather, they have written policies on the assumption that a loss is fortuitous if the insured does not expect or intend it.⁸⁶

The inevitability test, moreover, was developed to make sure that a marine insurance policy did not cover inherent defects in machinery or normal wear and tear.⁸⁷ That purpose now can be accomplished by inherent defect exclusions, which generally preclude coverage for latent defects and wear and tear.⁸⁸

Finally, the purpose of most modern liability insurance policies is to protect the insured from the consequences of his or her own negligence.⁸⁹ An inevitability standard for fortuity would undercut this goal because, in many cases, an insured would be denied coverage when he or she was negligent in failing to discover a loss that was inevitable.⁹⁰ An actual knowledge test is preferable because it protects the insured from the consequences of his or her negligence.⁹¹

3. The actual knowledge and reasonable insured tests

The loss in progress doctrine raises another fundamental question: where the loss in progress doctrine requires the insured to be aware of a loss, must the insured actually know of a loss, or is it sufficient that a reasonable person, under similar circumstances, would realize that a loss

82. *Id.* at 858. On that basis, the court granted Kilroy's motion for summary judgment on the coverage issues. *Id.* at 861.

83. *Id.* at 858; CAL. INS. CODE § 250 (West 1972).

84. *Insurance Co. of N. Am. v. United States Gypsum Co.*, 678 F. Supp. 138, 142 (W.D. Va. 1988), *aff'd*, 870 F.2d 148 (4th Cir. 1989).

85. *Id.*

86. *Compagnie des Bauxites v. Insurance Co. of N. Am.*, 724 F.2d 369, 372 (3d Cir. 1983) (applying Pennsylvania law); *United States Gypsum Co.*, 678 F. Supp. at 142.

87. *Redna Marine Corp. v. Poland*, 46 F.R.D. 81, 87 (S.D.N.Y. 1969); *Mellon v. Federal Ins. Co.*, 14 F.2d 997, 1002-03 (S.D.N.Y. 1926).

88. *See, e.g., Kilroy Indus. v. United Pac. Ins. Co.*, 608 F. Supp. 847, 856-57 (C.D. Cal. 1985).

89. *See Goodman v. Fireman's Fund Ins. Co.*, 600 F.2d 1040, 1042 (4th Cir. 1979); *United States Gypsum Co.*, 678 F. Supp. at 142.

90. *Chu v. Canadian Indem. Co.*, 224 Cal. App. 3d 86, 98-99, 274 Cal. Rptr. 20, 28 (1990).

91. *Id.* at 99, 274 Cal. Rptr. at 28.

has taken or will take place? Most courts require actual knowledge by the insured.⁹² In addition, a few courts using this actual knowledge standard also apply an even higher standard of knowledge; these courts require what appears to be an intent to defraud the carrier before allowing the loss in progress defense.⁹³

a. actual knowledge

In *Township of Gloucester v. Maryland Casualty Co.*⁹⁴ the district court refused to find coverage for an environmental claim under a liability policy.⁹⁵ The New Jersey Department of Environmental Protection ordered a toxic waste dump site closed and filed a complaint against the Township of Gloucester in October of 1980, requesting compensatory damages and an injunction requiring that the dump be cleaned up.⁹⁶ In July 1982, Home Insurance issued its policy to the Township of Gloucester.⁹⁷ When the insured sought coverage for the complaint under the policy, Home Insurance declined.⁹⁸ The court, which upheld Home's denial because the township had actual knowledge of the loss before its application for insurance,⁹⁹ stated "[o]ne cannot obtain insurance for a risk that the insured knows has already transpired."¹⁰⁰

In Texas the standard for loss in progress or fortuity is equally broad. In *Burch v. Commonwealth County Mutual Insurance Co.*,¹⁰¹ damage to plaintiff's automobile occurred during the stipulated policy period but prior to issuance of the policy.¹⁰² The court found coverage because the insured had no knowledge of the loss.¹⁰³ While the court applied an actual knowledge test, it did not require proof of an intent to defraud.¹⁰⁴

92. *Burch v. Commonwealth County Mut. Ins. Co.*, 450 S.W.2d 838, 841 (Tex. 1970).

93. *See, e.g., Insurance Co. of N. Am. v. United States Gypsum Co.*, 870 F.2d 148, 153 (4th Cir. 1989), *aff'g* 678 F. Supp. 138 (W.D. Va. 1988) (holding policy void if wilful concealment or fraud can be shown).

94. 668 F. Supp. 394 (D.N.J. 1987).

95. *Id.* at 402-03.

96. *Id.* at 396.

97. *Id.*

98. *Id.* at 402.

99. *Id.* at 402-03. Home Insurance, along with a number of other insurers, had moved for summary judgment. The court granted Home Insurance's motion but denied the motions of the other insurance carriers. *Id.* at 403.

100. *Id.*

101. 450 S.W.2d 838 (Tex. 1970).

102. *Id.* at 839. The accident occurred on July 18, 1967, while the policy was issued on July 19, 1967, providing coverage forward from July 18, 1967. *Id.*

103. *Id.* at 841.

104. *Id.*

[I]t is contrary to public policy for an insurance company, the business of which is

Conversely, New York courts are likely to use a stricter actual knowledge standard. In *City of Johnstown v. Bankers Standard Insurance Co.*¹⁰⁵ the Second Circuit Court of Appeals held that New York courts would demand proof approaching an intent to defraud before they would allow coverage to be denied on the basis of a known risk.¹⁰⁶ An intent to defraud requires that the insured actually know of the loss and, in addition, fraudulently conceal the loss from the insurer when applying for insurance.¹⁰⁷

The court in *City of Johnstown* based its decision on two rules: (1) an insured cannot insure property that he or she knows is damaged before the policy becomes effective;¹⁰⁸ and (2) an insured cannot recover when he or she fraudulently conceals or misrepresents material facts to the insurer when applying for the policy.¹⁰⁹ The court applied these rules and found neither fraud nor misrepresentation.¹¹⁰ The court rejected the insurers' argument that coverage for a Comprehensive Environmental Response, Compensation, and Recovery Act (CERCLA) action¹¹¹ against the city was barred as a known risk.¹¹² The court purposely shied away from holding that "a risk, once 'known,' was uninsurable."¹¹³

Minnesota case law suggests that the Minnesota courts require evidence of fraudulent intent to conceal a loss before they will allow a car-

affected with a public interest, knowingly to assume the burden of a loss that occurred prior to making the contract

Most courts that have considered the question hold that recovery may be had on a policy antedated to include the time at which a loss occurred provided neither the applicant nor the insurer knew of the loss when the contract was made We approve and adopt this as a general rule, because in our opinion it is entirely sound as applied to the facts of this case. Aside from any question of protecting insurance companies against possible fraud on the part of their customers or agents, we can think of no reason for holding that the parties may not effectively contract for the insurer to assume the risk of a loss that may or may not have occurred when the contract is made.

Id. at 840-41.

105. 877 F.2d 1146 (2d Cir. 1989) (applying New York law). This case was an appeal of an order granting an insurer's motion for summary judgment, which the Second Circuit reversed. *Id.* at 1147.

106. *Id.* at 1149-50, 1152-53 (holding that expected or intended losses only excluded if they are not accidental).

107. *Id.* at 1152-53.

108. *Id.* at 1153.

109. *Id.*

110. *Id.*

111. 42 U.S.C. §§ 9601-9675 (1988) (regulating management and disposal of hazardous substances).

112. *City of Johnstown*, 877 F.2d at 1153.

113. *Id.* The Second Circuit hesitated to recognize the known risk doctrine and thereby "adopt innovative theories that may distort established state law." *Id.*

rier to invoke a loss in progress defense. The insured in *Waseca Mutual Insurance Co. v. Noska*¹¹⁴ negligently caused fires on the properties of third parties after the expiration of his homeowner's policy.¹¹⁵ Shortly after the fires, Noska discovered that the policy had expired and approached his insurance agent about renewing the policy.¹¹⁶ The agent, unaware that Noska had caused the fires, suggested that he increase the policy limits for personal liability and Noska agreed.¹¹⁷ The agent, on his own initiative, backdated the new policy to the expiration date of the original policy.¹¹⁸ Noska had not told the agent about the cause of the fires because Noska believed that the homeowner's policy covered only accidents occurring on his own property.¹¹⁹ The insurance carrier contested the demand that the higher limit be paid.¹²⁰ The Minnesota Supreme Court concluded that the carrier could avoid coverage for the new limit only if it proved fraud.¹²¹ The court found no fraud because the insured had no knowledge of or intent to backdate the increased limit on his liability policy.¹²²

Waseca Mutual Insurance Co. thus raises the question, actual knowledge of what? Whereas *Township of Gloucester v. Maryland Casualty Co.* required only the insured's actual knowledge of an undisclosed loss to invoke the loss in progress defense,¹²³ *Waseca Mutual Insurance Co.* required fraudulent intent to conceal the loss—in other words, actual knowledge of a *potentially valid claim*.¹²⁴ Although in some cases an insurance carrier may be held to a higher standard of proving the insured's intent to defraud by misrepresentation of a material fact, most courts do not require more than actual knowledge.

b. reasonable insured standard

Although the loss in progress doctrine has existed for well over eighty years in the United States,¹²⁵ it remains largely undeveloped in

114. 331 N.W.2d 917 (Minn. 1983).

115. *Id.* at 919, 924.

116. *Id.* at 924.

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* at 926.

122. *Id.* at 924-26.

123. 668 F. Supp. 394, 403 (D.N.J. 1987).

124. *Waseca Mut. Ins. Co.*, 331 N.W.2d at 924; *see supra* notes 121-22 and accompanying text.

125. *See, e.g., Mellon v. Federal Ins. Co.*, 14 F.2d 997, 1002-03 (S.D.N.Y. 1926).

many states.¹²⁶ For example, only California courts have considered the issue of whether the insured's knowledge of a loss is to be judged by a reasonable insured standard¹²⁷ or by a subjective standard that focuses on the insured's actual knowledge.¹²⁸ Moreover, California courts disagree on the answer to this question. An intermediate California appellate court has held that the insured must actually know of the loss before that loss will be considered a loss in progress.¹²⁹ That court explicitly rejected the reasonable insured test.¹³⁰ By contrast, the California Supreme Court has implied that an insured can be held to have constructive knowledge under a reasonable insured test.¹³¹

In *Chu v. Canadian Indemnity Co.*¹³² the court required the insured developer Hilbert Chu to have actual knowledge of defects in a condominium project before the carrier could prevail on a loss in progress defense.¹³³ The claims in dispute involved the carrier's coverage of Chu for third party claims by homeowners for construction defects.¹³⁴ Because Chu had knowledge of the conditions giving rise to the loss in question prior to the issuance of the policy, the insurer invoked a loss in progress defense in its motion for summary judgment.¹³⁵

The trial court granted summary judgment in favor of Canadian Indemnity, finding that it had no duty to defend or indemnify Chu.¹³⁶ The California Court of Appeal reversed because a triable issue of fact existed as to whether Chu had knowledge of the defects when the Canadian Indemnity policy was issued.¹³⁷ The court of appeal believed that the subjective, actual knowledge of the insured was the key issue in applying the loss in progress rule.¹³⁸

126. Most courts have made the simple statement that insurance should only cover fortuitous losses but have found it largely unnecessary to explain the concept of fortuity in detail. See, e.g., *Bartholomew v. Appalachian Ins. Co.*, 655 F.2d 27, 28-29 (1st Cir. 1981); *Mattis v. State Farm Fire & Casualty Co.*, 454 N.E.2d 1156, 1163-64 (Ill. App. Ct. 1983).

127. *Prudential-LMI Commercial Ins. v. Superior Court*, 51 Cal. 3d 674, 699, 798 P.2d 1230, 1247, 274 Cal. Rptr. 387, 404 (1990).

128. *Chu v. Canadian Indem. Co.*, 224 Cal. App. 3d 86, 96-98, 274 Cal. Rptr. 20, 26-29 (1990).

129. *Id.* at 97-99, 274 Cal. Rptr. at 27-28.

130. *Id.* at 99, 274 Cal. Rptr. at 28.

131. *Prudential-LMI Commercial Ins.*, 51 Cal. 3d at 699, 798 P.2d at 1247, 274 Cal. Rptr. at 404.

132. 224 Cal. App. 3d 86, 274 Cal. Rptr. 20 (1990).

133. *Id.* at 96-98, 274 Cal. Rptr. at 26-29.

134. *Id.* at 90, 274 Cal. Rptr. at 22.

135. *Id.* at 93, 274 Cal. Rptr. at 24.

136. *Id.*

137. *Id.* at 103, 274 Cal. Rptr. at 31.

138. *Id.* at 97-99, 274 Cal. Rptr. at 27-28.

The court found that coverage was not precluded merely because Chu should have discovered the defect but negligently failed to do so.¹³⁹ Even if Chu was negligent in failing to investigate and discover defects that would have been investigated by a reasonably prudent person, coverage was not barred because "a major purpose of third party liability insurance is to protect the insured from claims for negligence."¹⁴⁰

Ignoring the court of appeal's holding in *Chu*, six weeks later the California Supreme Court implied that a reasonable insured test was enough to support a loss in progress defense.¹⁴¹ In *Prudential-LMI Commercial Insurance v. Superior Court*¹⁴² the court determined that the loss in progress rule required a "manifestation" test as the trigger of coverage under first party property policies.¹⁴³ The court held a loss to be manifest at the time the insured is required to notify the carrier of the loss under the property policy.¹⁴⁴ In adopting a reasonable insured standard the court stated:

We have previously defined the term "inception of the loss" as that point in time when appreciable damage occurs and is or should be known to the insured, such that a reasonable insured would be aware that his notification duty under the policy has been triggered. We conclude that the definition of "manifestation of the loss" must be the same.¹⁴⁵

In short, if an insured actually becomes aware of damage or injury such that a reasonable person in the insured's place would be aware of the loss, then the loss is manifest and the loss in progress rule precludes coverage.¹⁴⁶

Curiously, the California Supreme Court could have decertified the

139. *Id.* at 97, 274 Cal. Rptr. at 27.

140. *Id.* at 99, 274 Cal. Rptr. at 28.

141. *Prudential-LMI Commercial Ins. v. Superior Court*, 51 Cal. 3d 674, 798 P.2d 1230, 274 Cal. Rptr. 387 (1990). Comparing *Chu* to *Prudential-LMI Commercial Insurance* may be like comparing apples and oranges. The California Supreme Court in *Prudential-LMI Commercial Insurance* expressly limited its holding to first party property damage cases, *id.* at 679, 798 P.2d at 1232, 274 Cal. Rptr. at 389, and *Chu* is a third party liability case, *Chu*, 224 Cal. App. 3d at 90, 274 Cal. Rptr. at 22. In first party claims it is difficult to prove actual knowledge of one's own loss, while in third party claims actual knowledge is easily shown by the instigation of the claim by the third party.

142. 51 Cal. 3d 674, 798 P.2d 1230, 274 Cal. Rptr. 387 (1990).

143. *Id.* at 699, 798 P.2d at 1246, 274 Cal. Rptr. at 403-04. Under the manifestation test, "insurers whose policy terms commence after initial manifestation of the loss are not responsible for any potential claims relating to the previously discovered and manifested loss." *Id.* at 699, 798 P.2d at 1246-47, 274 Cal. Rptr. at 403-04.

144. *Id.* at 699, 798 P.2d at 1247, 274 Cal. Rptr. at 402-03.

145. *Id.* at 699, 798 P.2d at 1247, 274 Cal. Rptr. at 404.

146. *Id.*

Chu case and thereby removed it from publication, indicating its disapproval of an actual knowledge test.¹⁴⁷ Yet, the supreme court denied a petition for review in *Chu* and allowed the case to remain published.¹⁴⁸ Given this apparent disagreement between the California Court of Appeal in *Chu* and the California Supreme Court in *Prudential-LMI Commercial Insurance*, the safest course for a carrier applying California law is to invoke a loss in progress defense only when the insured has actual knowledge of a loss at the time a policy is issued.¹⁴⁹

c. actual knowledge test is more equitable

The actual knowledge test is supported by the very idea of insurance, particularly liability insurance. Liability insurance protects an insured from the consequences of his or her own failure to act, indifference or negligence.¹⁵⁰ Therefore, if a reasonable insured would have known of a loss but the actual insured did not because of negligence, the insured should have coverage. Only then are the insured's reasonable expectations under a policy met because the insured is protected from his or her own negligence.¹⁵¹

In addition, some states have made it a matter of public policy to construe insurance coverage broadly so as to ensure that third party claimants are compensated for their injuries.¹⁵² The loss in progress defense defeats coverage entirely; the claimant receives no compensation.

147. A party seeking review of a decision by a California Court of Appeal can file a petition for review with the California Supreme Court. The California Supreme Court rather than grant the petition can order that the opinion not be published in the official reports. This action means the case cannot be cited as precedent in any California state court. See CAL. CT. R. 976(c)(2) (West 1981 & Supp. 1991).

The California Supreme Court uses depublishment orders to signal its position on an issue to lower courts. See *People v. Dee*, 222 Cal. App. 3d 760, 763-64, 272 Cal. Rptr. 208, 210 (1990); Joseph R. Grodin, *The Depublishment Practice of the California Supreme Court*, 72 CAL. L. REV. 514, 515 (1984).

148. Petition for Review denied December 12, 1990.

149. The actual knowledge test favors the insured because it upholds coverage even if he or she was negligent in failing to discover a defect. See *Chu v. Canadian Indem. Co.*, 224 Cal. App. 3d 86, 98-99, 274 Cal. Rptr. 20, 28-29 (1990). By using an actual knowledge standard for a loss in progress defense, the insurer can avoid the argument that it is advocating a standard that favors it, and not the insured. The insured may well characterize the reasonable insured test as pro-insurer because it may not require coverage when the insured was at fault in failing to detect a loss. See *id.* at 99-100, 274 Cal. Rptr. at 28-29.

150. See *id.* at 99, 274 Cal. Rptr. at 28.

151. *Redna Marine Corp. v. Poland*, 46 F.R.D. 81, 87 (S.D.N.Y. 1969); *Chu*, 224 Cal. App. 3d at 99-100, 274 Cal. Rptr. at 28-29.

152. *Barrera v. State Farm Mut. Auto. Ins. Co.*, 71 Cal. 2d 659, 670-73, 456 P.2d 674, 682-84, 79 Cal. Rptr. 106, 114-16 (1969); *State Farm Mut. Auto. Ins. Co. v. Wall*, 222 A.2d 282, 289 (N.J. Super. Ct. App. Div. 1966).

Because the loss in progress doctrine jeopardizes compensation for victims of tortfeasors, it should be narrowly interpreted. One way to accomplish this goal of protecting victims of tortfeasors and upholding the insured's reasonable expectations of coverage is to require that the insured have actual knowledge of a loss before that loss becomes uninsurable.

4. Requiring knowledge of what: Losses that may later give rise to a claim or actual claims?

The third issue insurers and courts must consider in applying the loss in progress doctrine is whether the insured is merely required to know of a loss that may later give rise to a claim against the insured, or whether the insured must know of claims actually made as a result of the loss. An intermediate possibility is that the loss in progress doctrine precludes coverage once the insured knows his or her actions have caused damage or injury—a loss—but is unaware of any claims against him or her.¹⁵³

a. requiring knowledge of an actual claim

Courts in several states apply the loss in progress doctrine only when the insured knows of an actual claim made before a policy's issuance.¹⁵⁴ For example, in *Bartholomew v. Appalachian Insurance Co.*,¹⁵⁵ the insured, the manufacturer of a defective car-washing machine, was sued long before the policy was issued.¹⁵⁶ The First Circuit, applying Rhode Island law, concluded that notice of the claim terminated coverage because "[t]he concept of insurance is that the parties, in effect, wager against the occurrence or non-occurrence of a specified event; the carrier insures against a risk, not a certainty."¹⁵⁷ The loss in progress defense succeeded because the insured knew of the defects and of the lawsuit against it before the policies took effect.¹⁵⁸

In *Appalachian Insurance Co. v. Liberty Mutual Insurance Co.*¹⁵⁹ a

153. See, e.g., *Insurance Co. of N. Am. v. United States Gypsum Co.*, 870 F.2d 148, 151-53 (4th Cir. 1989) (applying Virginia law), *aff'g* 678 F. Supp. 138 (W.D. Va. 1988); *Essex House v. St. Paul Fire & Marine Ins. Co.*, 404 F. Supp. 978, 988-90 (S.D. Ohio 1975) (applying Ohio law); *Sabella v. Wisler*, 59 Cal. 2d 21, 34, 377 P.2d 889, 897, 27 Cal. Rptr. 689, 697 (1963). This issue as framed arises in third party claims because it assumes someone has made a claim against the insured.

154. See *infra* notes 155-73 and accompanying text.

155. 655 F.2d 27 (1st Cir. 1981).

156. *Id.* at 28.

157. *Id.* at 29.

158. *Id.* at 28-29.

159. 676 F.2d 56 (3d Cir. 1982).

number of plaintiffs, who later sued Liberty Mutual for sex discrimination, had filed administrative claims with the Equal Employment Opportunity Commission (EEOC) before Appalachian issued its liability policy to Liberty Mutual.¹⁶⁰ The Third Circuit, applying Pennsylvania law, concluded that Appalachian did not owe coverage because the loss was already in progress and no longer fortuitous.¹⁶¹ The court found Liberty Mutual must have known of the claim before the policy was issued because the plaintiffs' administrative complaints to the EEOC preceded the Appalachian policy's effective date.¹⁶²

In *United States v. Conservation Chemical Co.*¹⁶³ the court concluded that no insurable occurrence had taken place under policies effective after the federal government brought suit against the insured for reimbursement of cleanup costs.¹⁶⁴ Thus, coverage was denied.¹⁶⁵ A similar result was reached in *Township of Gloucester v. Maryland Casualty Co.*,¹⁶⁶ in which the court upheld a denial of coverage because the Environmental Protection Agency (EPA) had filed its complaint against the insured for reimbursement of cleanup costs before the carrier issued its policy.¹⁶⁷

Some courts that require an insured to have knowledge of an actual claim also require the insured to have fraudulent intent before a carrier can invoke a loss in progress defense.¹⁶⁸ These courts believe that only actual knowledge of a claim will provide convincing evidence of fraud.¹⁶⁹ For example, in Minnesota¹⁷⁰ and New York¹⁷¹ an actual claim is required as well as proof of an intent to defraud. In *City of Johnstown v. Bankers Standard Insurance Co.*¹⁷² the Second Circuit observed that "insurance will not normally cover damages that are, as a result of legal or

160. *Id.* at 58-59.

161. *Id.* at 63.

162. *Id.* Although the court does not discuss whether Liberty Mutual knew its employees had complained to the EEOC, the court must have assumed it had such knowledge. Either the claimants would have sent Liberty Mutual copies of the complaints, or the EEOC would have notified Liberty Mutual that the complaints had been made.

163. 653 F. Supp. 152 (W.D. Mo. 1986) (applying Missouri law).

164. *Id.* at 178-81.

165. *Id.* at 181, 182-88.

166. 668 F. Supp. 394, 402-03 (D.N.J. 1987).

167. *Id.* at 403.

168. See, e.g., *id.* at 402-03; *Arley v. United Pac. Ins. Co.*, 379 F.2d 183, 187-88 (9th Cir.), cert. denied, 390 U.S. 950 (1968); *Waseca Mut. Ins. Co. v. Noska*, 331 N.W.2d 917, 924-26 (Minn. 1983).

169. See *supra* note 168.

170. *Waseca Mut. Ins. Co.*, 331 N.W.2d at 924-25.

171. *City of Johnstown v. Bankers Standard Ins. Co.*, 877 F.2d 1146, 1152-53 (2d Cir. 1989) (applying New York law).

172. 877 F.2d 1146 (2d Cir. 1989).

administrative proceedings, already apparent at the inception of insurance."¹⁷³

b. requiring knowledge of loss that may later give rise to claim

Other cases do not require knowledge of an actual claim against an insured, but allow a carrier to invoke the loss in progress defense if the insured knows of circumstances that may later lead to claims.¹⁷⁴ For example, on the day plaintiffs took out a flood insurance policy in *Presley v. National Flood Insurers Ass'n*¹⁷⁵ flood waters had already entered the basement of the plaintiffs' home causing minimal damage, but had not yet reached the upper floors of the house, where the greatest damage occurred.¹⁷⁶ The court found that the loss was in progress because the insureds knew at the time they applied for the policy that the loss and the claim for that loss were inevitable.¹⁷⁷

Similarly in *Drewett v. Aetna Casualty & Surety Co.*¹⁷⁸ the insured's home had been built above the ground on wooden stilts. By the time the insured applied for a flood policy, flood water had surrounded the stilts but had not yet entered the house.¹⁷⁹ Because the court believed that the insured knew that a loss and subsequent claim were inevitable, it upheld a denial of coverage.¹⁸⁰ It was also concluded that no coverage was owed because the loss was in progress and no longer contingent in *New Castle County v. Hartford Accident & Indemnity Co.*¹⁸¹ The insured, a county

173. *Id.* at 1153 (citation omitted).

174. *See, e.g.,* *New Castle County v. Hartford Accident & Indem. Co.*, 685 F. Supp. 1321, 1329 (D. Del. 1988); *Presley v. National Flood Insurers Ass'n*, 399 F. Supp. 1242, 1245 (E.D. Mo. 1975).

175. 399 F. Supp. 1242 (E.D. Mo. 1975) (applying Missouri law).

176. *Id.* at 1243.

177. *Id.* at 1245.

Other courts have pointed out that this [loss in progress] doctrine should be equally applicable where the loss insured against is in progress at time insurance is purchased. . . .

In the instant case the plaintiffs' residence was in a continuous state of flood from March 25th or 26th until sometime in May or June of 1973. *The Presleys were fully aware of their predicament* both at the time they applied for insurance and on the effective date of the policy in question. Under these circumstances recovery must be denied.

Id. at 1244-45 (emphasis added).

178. 539 F.2d 496 (5th Cir. 1976) (applying Louisiana law).

179. *Id.* at 497-98.

180. *Id.* (affirming district court's holding that no coverage is owed if loss is in progress when policy takes effect); *see also* *Summers v. Harris*, 573 F.2d 869, 872 (5th Cir. 1978) (following rule in *Drewett v. Aetna Casualty & Surety Co.*, 539 F.2d 496, 497 (5th Cir. 1976): "[W]here a loss already is in progress at the time a policy is issued, the contract of insurance does not take effect.").

181. 685 F. Supp. 1321, 1330 (D. Del. 1988) (applying Delaware law).

that operated a landfill, knew at the time it applied for a policy that leaks from the landfill were polluting groundwater, but it did not know the cause of the leaks nor the extent of the problem.¹⁸²

The rule in California is unclear. Some California courts go one step further by permitting a carrier to invoke the loss in progress defense when the insured has actual knowledge of the loss, even if the insured has no knowledge of claims before that point.¹⁸³ In *Chu v. Canadian Indemnity Co.*¹⁸⁴ the California Court of Appeal stated that the insured's knowledge of defects in a condominium project were sufficient to terminate coverage.¹⁸⁵ The court never suggested that those defects had to rise to the level of a claim. However, in *Sabella v. Wisler*¹⁸⁶ the California Supreme Court rejected an inevitability of loss argument, holding that any contingent or unknown event may be insured against. In other words, subjective knowledge of a loss was enough to make a loss no longer fortuitous, so that denial of coverage was appropriate.¹⁸⁷

Where knowledge of a loss is sufficient to satisfy the loss in progress defense, it remains doubtful whether an insured can avoid the loss in progress rule when, at the time a policy is issued, the insured knows of the loss but does not know of the extent of damage or injury surrounding the loss.¹⁸⁸ Allowing coverage when loss is known, but not its extent, is unworkable. First, it encourages misrepresentation by insureds in applying for policies. Provided that the insured gives notice of a loss, the in-

182. *Id.* at 1324-26. The court stated: "Similarly, in the case at bar, the loss may not have been a certainty when the policy was issued. However, the process causing the loss began before the policy was issued, and the County received strong indications that a loss would occur." *Id.* at 1329.

183. This conclusion is consistent with § 22 of the California Insurance Code which states that insurance can only be provided against a contingent or unknown *event* as opposed to a contingent or unknown *claim*. CAL. INS. CODE § 22 (West 1972).

184. 224 Cal. App. 3d 86, 274 Cal. Rptr. 20 (1990).

185. *Id.* at 98-99, 274 Cal. Rptr. at 28.

186. 59 Cal. 2d 21, 377 P.2d 889, 27 Cal. Rptr. 689 (1963).

187. *Id.* at 34, 377 P.2d at 897, 27 Cal. Rptr. at 697; see also *Snapp v. State Farm Fire & Casualty Co.*, 206 Cal. App. 2d 827, 830, 24 Cal. Rptr. 44, 45-46 (1962) (distinguishing definition of inevitability from contingent event or risk).

188. An example is the following situation: the insured owns a farm containing a number of underground gasoline tanks. If the insured is aware that the tanks have leaked for a lengthy period of time, the insured is on notice of a possible loss. Yet, he or she may not know the extent of pollution damage the leaks have caused, or the extent of possible injuries to his or her neighbors who may have used polluted groundwater. If the test for loss in progress is that the insured must know the extent of damage or injuries, the insured could disclose only the leaks to the insurer and the insurer could still write a policy. If years later homeowners or farmers near the tanks complained of groundwater pollution, their claims would remain insurable. See, e.g., *Advanced Micro Devices, Inc. v. Great Am. Surplus Lines Ins. Co.*, 199 Cal. App. 3d 791, 801-02, 245 Cal. Rptr. 44, 50 (1988) (concluding no coverage because insured knew of pre-existing defect and was only uncertain as to extent of problem).

sured will be covered. Insureds are encouraged to mention losses on their applications but to minimize or disguise those losses. Unfortunately, underwriting personnel for insurance carriers frequently do not review policy applications carefully to determine whether insureds have attempted to dismiss or hide the size of possible losses or claims.¹⁸⁹ It is entirely possible that an insured, facing a major loss, could disguise that loss on the insurance application and persuade an insurer to issue a policy.

Second, allowing such a narrow interpretation of the loss in progress doctrine encourages insurers to risk insolvency by providing coverage for questionable risks.¹⁹⁰ A carrier in need of premium income may be tempted to underwrite a dubious risk. Such sloppy underwriting practices can lead to insurer insolvency.¹⁹¹ It is doubtful that most courts will interpret the loss in progress doctrine so narrowly that the insured will be required to know the extent of damages, so that insureds will be tempted to tell half-truths on their applications and insurers will be tempted to underwrite highly questionable risks. The courts eventually should hold that the loss in progress rule precludes coverage when an insured has actual notice of a loss, even though the insured is unaware of the extent of damage or injury caused by the loss.

B. Knowledge of One Loss is Not Necessarily Knowledge of Other Unrelated Losses

Many progressive loss claims involve only a single injurious process or loss.¹⁹² Other claims, however, may involve several losses simultaneously. This is a distinct possibility in construction defects cases. A homeowner suing a developer can allege a number of defects which may or may not be related. For instance, a homeowner can charge that roofs leak and stucco was improperly applied allowing water leaks, and that the home was built on unstable soil leading to soil subsidence damage. All of these defects can be called faulty construction. Yet knowledge of one defect may not be considered knowledge of other defects because

189. *Insurance Co. of N. Am. v. United States Gypsum Co.*, 870 F.2d 148, 150 (4th Cir. 1989) (applying Virginia law), *aff'g* 678 F. Supp. 138 (W.D. Va. 1988).

190. *See, e.g., id.*; *National Union Fire Ins. Co. v. Ambassador Group*, 691 F. Supp. 618, 621 (E.D.N.Y. 1988); *Corcoran v. Frank B. Hall & Co.*, 545 N.Y.S.2d 278, 279 (App. Div. 1989).

191. *See supra* note 190 and accompanying text.

192. *See, e.g., Summers v. Harris*, 573 F.2d 869 (5th Cir. 1978) (homeowners brought claim against insurer for damage caused by one flood in progress for several days); *Drewett v. Aetna Casualty & Sur. Co.*, 539 F.2d 496 (5th Cir. 1976) (insured brought claim against insurer for damage caused by levee that broke as result of ongoing flood).

they are defects unrelated by cause. This rule leads to the curious possibility that the loss in progress doctrine may include coverage for some defects in a construction claim while precluding coverage for others in the same claim.¹⁹³

In *Chu v. Canadian Indemnity Co.*¹⁹⁴ Canadian Indemnity argued that before it had issued its policy, Chu was on notice of faulty construction, which it defined as including all defects in a condominium project.¹⁹⁵ The trial court agreed with this proposition, but the court of appeal did not.¹⁹⁶ The court of appeal believed that each defect had to be analyzed separately, and that knowledge of one defect did not mean that the insured had knowledge of other unrelated defects in the project.¹⁹⁷

C. Knowledge of the Cause of a Loss

If the loss in progress doctrine precludes coverage when an insured has actual knowledge of a loss, but not necessarily of the actual claim or extent of injuries or damages the loss has caused, the court's inquiry is not over. Some California courts have posed the question of whether the insured must know the cause of a loss or merely that a loss has taken place.¹⁹⁸

In *Fireman's Fund Insurance Co. v. Aetna Casualty & Surety Co.*¹⁹⁹ the California Court of Appeal did not analyze the loss in progress doctrine extensively, but considered the issue of whether coverage existed only when a defect first manifested itself to the insured.²⁰⁰ Because mani-

193. For example, in *Chu v. Canadian Indemnity Co.*, 224 Cal. App. 3d 86, 274 Cal. Rptr. 20 (1990), Chu, the insured, had detected cracking and uplifting in the pool area of a condominium complex he owned. *Id.* at 90, 274 Cal. Rptr. at 22. He had notice of these problems before the Canadian Indemnity policy became effective and therefore obviously could not claim coverage for them. *Id.* The court made it clear, however, that Chu could claim coverage under the policy for defects in the foundation, of which he knew nothing before the policy was issued. *Id.*

194. 224 Cal. App. 3d 86, 274 Cal. Rptr. 20 (1990).

195. *Id.* at 97, 274 Cal. Rptr. at 27.

196. *Id.* at 97-98, 274 Cal. Rptr. at 27-28.

197. *Id.* at 98, 274 Cal. Rptr. at 27. The court stated:

We are persuaded . . . [to] reject[] . . . the trial court's conclusion that manifestation of one defect demonstrates the project suffers from the generic defect of "faulty construction," and that later manifestations of distinct and unrelated problems are merely remanifestations of the same defect of "faulty construction." Instead, each set of distinct defects must be analyzed separately to determine whether Chu had knowledge of those defects at the time they sold the units.

Id. at 98, 274 Cal. Rptr. at 28.

198. *Id.* at 98-99, 274 Cal. Rptr. at 28 (implying insured must know cause of loss).

199. 223 Cal. App. 3d 1621, 273 Cal. Rptr. 431 (1990). This case was an appeal from a trial court decision granting Aetna's motion for summary judgment. The court of appeal affirmed the order, holding that Aetna did not owe coverage. *Id.* at 1628-30, 273 Cal. Rptr. at 434-36.

200. *Id.* at 1625-30, 273 Cal. Rptr. at 432-34.

festation of a defect to the insured is frequently actual notice of a loss, this case is significant.

Fireman's Fund Insurance Co. involved the successive coverage of two insurance companies. Fireman's Fund had sued another insurer, Aetna Casualty & Surety Co., contending that Aetna should have participated with Fireman's Fund in the settlement of a construction defects action.²⁰¹ Fireman's Fund argued that the loss manifested itself during Aetna's policy term because the cause of the loss became known at that time.²⁰² Fireman's Fund relied on a number of cases holding that the statute of limitations for personal injury and other actions did not begin to run until "a person actually discovers, or reasonably should have discovered his injury and its negligent cause."²⁰³ The court of appeal rejected this delayed discovery rule because liability policies involving allocation of loss among insurers do not involve the same public policy issues as cases involving actions against fiduciaries, where courts typically apply the delayed discovery rule to protect fiduciaries from missing statutes of limitation.²⁰⁴ Thus, the discovery rule did not merit application in a coverage dispute between insurers.²⁰⁵

In *Chu v. Canadian Indemnity Co.*²⁰⁶ the same court of appeal implied that the insured had to know the cause of the loss before the loss in progress doctrine would preclude coverage.²⁰⁷ In March 1982, Canadian Indemnity issued a policy to a homeowner's association that named Chu as an additional insured.²⁰⁸ Substantial soil subsidence damage in the project eventually led the City of Los Angeles to condemn all but two of the project's units as unsafe.²⁰⁹ In August 1984, after nineteen units had been sold, Chu discovered that the soil subsidence was caused by design

201. *Id.* at 1623, 273 Cal. Rptr. at 431.

202. *Id.* at 1630, 273 Cal. Rptr. at 435.

203. *Id.* This is the delayed discovery rule. *Id.* The purpose of the delayed discovery rule is to protect aggrieved parties who justifiably are ignorant of their right to sue. *Id.* (citing *Tijsseling v. General Accident Fire & Life Assurance Corp.*, 55 Cal. App. 3d 623, 628, 127 Cal. Rptr. 681, 684 (1976)).

204. *Id.*

205. *Id.* The court of appeal stated:

[The delayed discovery rule] is most commonly associated with actions against fiduciaries when strict adherence to the date of injury rule for commencing the statute of limitations would be unfair and would encourage wrongdoers to mislead their fiduciary to delay bringing suit. These policies which support the rule are not effectuated by applying the delayed discovery rule in this context.

Id. (citation omitted).

206. 224 Cal. App. 3d 86, 274 Cal. Rptr. 20 (1990).

207. *Id.* at 98-99, 274 Cal. Rptr. at 28.

208. *Id.* at 90, 274 Cal. Rptr. at 22.

209. *Id.* at 91-92, 274 Cal. Rptr. at 23.

defects in the foundations.²¹⁰ The unstable soil and defective design meant that the foundations could not support the buildings.²¹¹ Had the foundations been designed properly, the soil's instability would have made no difference because the foundations would have stabilized the buildings.²¹²

In early 1982, before he became insured under the Canadian Indemnity policy, Chu noticed cracking and uplifting in the complex's pool and driveways.²¹³ He learned that the cracks and improperly sealed joints had allowed moisture into the soil, which then expanded.²¹⁴ The soils engineer recommended that the cracks and joints be sealed and that rebars be installed.²¹⁵ Chu never made a claim for these defects and sold all the units despite the defects.²¹⁶

In 1983, however, Chu filed an earlier lawsuit against the architect, the civil engineers and the soil testing firm for other defects in the project.²¹⁷ These defects included leaks in the balconies and windows, leaks in the plumbing and cracks in the slabs.²¹⁸ Chu alleged negligence in the design and construction of the foundation and defects in the major concrete work.²¹⁹

Canadian Indemnity contended that the loss was in progress when Chu first began to notice soil subsidence-related defects in early 1982, before Canadian Indemnity's policy became effective.²²⁰ Canadian Indemnity pressed this contention in a motion for summary judgment.²²¹ Chu argued that he did not know the cause of those defects until much later, and therefore a triable issue of fact regarding his knowledge did exist.²²² Chu contended that knowledge of the cause of the defect was the only proper test for the loss in progress defense.²²³

The court of appeal agreed with Chu that there was a triable issue of fact and that the loss had not been in progress in early 1982.²²⁴ The court noted that only two parts of the project, the pool and the driveway,

210. *Id.*

211. *Id.* at 92, 274 Cal. Rptr. at 23.

212. *Id.*

213. *Id.* at 90, 274 Cal. Rptr. at 22.

214. *Id.*

215. *Id.*

216. *Id.* at 91, 274 Cal. Rptr. at 22-23.

217. *Id.* at 90, 274 Cal. Rptr. at 22.

218. *Id.*

219. *Id.* at 91, 274 Cal. Rptr. at 22-23.

220. *Id.* at 93, 274 Cal. Rptr. at 24.

221. *Id.*

222. *Id.*

223. *Id.*

224. *Id.* at 101, 274 Cal. Rptr. at 29.

had shown any subsidence damage in that year, and that this damage only involved cracks in poorly sealed joints.²²⁵ Chu argued that although he was aware of some defects, he was not aware of those that eventually surfaced after the units were sold.²²⁶ The court agreed and held that knowledge of those defects did not charge Chu with knowledge of other defects in the project.²²⁷

The 1983 lawsuit was a much closer question.²²⁸ In that lawsuit Chu alleged problems with soil subsidence and expansive soils, claiming that the foundations were unsuitable and were the cause of all of the structures' instability.²²⁹ The court of appeal found that there was a triable issue of fact regarding the loss in progress defense because Chu's knowledge of possible problems with soil subsidence and expansive soils did not automatically deem him to have knowledge of the defective foundations.²³⁰

Chu had noticed that soil subsidence problems existed in the condominium complex and that he might face a possible soil subsidence loss immediately after the completion of the complex in 1981.²³¹ Further, by 1983 he had sued the responsible soils engineers, alleging significant soil subsidence problems.²³² Yet, under the court of appeal's rationale, Chu's

225. *Id.* at 100, 274 Cal. Rptr. at 29.

226. *Id.*

227. *Id.* at 101, 274 Cal. Rptr. at 30 ("Knowledge of one set of problems does not equate with knowledge of unrelated defects.").

228. *Id.* at 102, 274 Cal. Rptr. at 30-31.

229. *Id.* at 102-03, 274 Cal. Rptr. at 30-31.

230. *Id.* at 102, 274 Cal. Rptr. at 30-31. The court stated:

While the 1983 lawsuit did allege that unspecified "defects" rendered the units "unsaleable" [sic] and "uninhabitable," Insurer attributes undue significance to this legal hyperbole. Insurer claims these "admissions" show Chu knew before they sold the units that the project's defective construction rendered it totally uninhabitable, and hence the injuries evidenced by the ultimate condemnation were expected and intended by Chu when they sold the units.

Certainly, the admissions contained in the 1983 lawsuit are admissible against Chu. While admissible, however, they are not conclusive, and the trier of fact is entitled to make findings contrary to the allegations of the prior proceedings. Here, there is room for such contrary findings. While Chu alleged the units were "unsaleable" [sic] and "uninhabitable" in 1983, there is evidence they may not have understood this condition to continue to prevail in 1984, since the units were in fact sold and inhabited in 1984. Whatever may have been Chu's knowledge as of 1983, it is their knowledge of the condition of the units when they were sold that is critical. Since the evidence indicates the units were being repaired for occupancy at a later date, a factual question is raised as to whether Chu believed, when they sold the units, the defects referenced in the 1983 lawsuit could be sufficiently remedied to remove the problems which had earlier led them to characterize the units as "uninhabitable."

Id. (citation omitted).

231. *Id.* at 90, 274 Cal. Rptr. at 22.

232. *Id.* at 91, 274 Cal. Rptr. at 22-23.

knowledge of soil subsidence problems was not enough to entirely preclude coverage.²³³ The court's analysis leads to the conclusion that only Chu's knowledge of the *cause* of the subsidence, which did not come until after the 1983 lawsuit, terminated coverage.

Cases outside of California have rejected the idea that knowledge of the cause of a loss is the key to the loss in progress doctrine.²³⁴ For example, in *Texas Eastern Transmission Corp. v. Marine Office-Appleton & Cox Corp.*²³⁵ the insured sought coverage under a property policy for the complete loss of a cave that collapsed.²³⁶ The insured could not prove the exact cause of the collapse.²³⁷ The carrier argued that no coverage existed unless the insured could prove the cause of the loss *and* prove that the cause was fortuitous.²³⁸ The Tenth Circuit disagreed, holding that the insured had to prove only that the *loss* was fortuitous.²³⁹ The insured did not have to prove the cause of that loss was fortuitous.²⁴⁰

In *Morrison Grain Co. v. Utica Mutual Insurance Co.*,²⁴¹ another case involving a property loss claim, the carrier made the same argument as did the carrier in *Texas Eastern Transmission Corp.*: the insured must prove that the *cause* of the loss was fortuitous.²⁴² The Fifth Circuit rejected this proposition because other "courts which have considered the question have rejected the notion that the insured must show the precise cause of loss to demonstrate fortuity."²⁴³

To require the insured to prove that the cause of a loss is fortuitous when a carrier raises the loss in progress defense is dubious at best. In many cases, an insured will not know the cause of a loss for years, perhaps even several years into litigation. This was the case in *Chu v.*

233. *Id.* at 103, 274 Cal. Rptr. at 31.

234. See, e.g., *Adams-Arapahoe Joint Sch. Dist. v. Continental Ins. Co.*, 891 F.2d 772, 775 (1989) (applying Colorado law); *Compagnie des Bauxites v. Insurance Co. of N. Am.*, 724 F.2d 369, 372 (1983) (applying Pennsylvania law); *Empire Underground Storage, Inc. v. Protective Nat'l Ins. Co.*, 685 F. Supp. 1187, 1189 (1988) (applying Kansas law); *Insurance Co. of N. Am. v. United States Gypsum Co.*, 678 F. Supp. 138, 141 (1988) (applying Virginia law), *aff'd*, 870 F.2d 148 (4th Cir. 1989); *Standard Structural Steel Co. v. Bethlehem Steel Corp.*, 597 F. Supp. 164, 183 (1984) (applying Connecticut law).

235. 579 F.2d 561 (10th Cir. 1978) (applying Oklahoma law).

236. *Id.* at 563.

237. *Id.*

238. *Id.*

239. *Id.* at 564 (holding "all risks" policy extends to all risks of fortuitous nature).

240. *Id.* at 564-65.

241. 632 F.2d 424 (5th Cir. 1980) (applying maritime law). *Morrison Grain Co.* arose out of the loss of a cargo of bagged urea being shipped from Romania to Mississippi. *Id.* at 427. The insured was unable to prove how the loss happened. *Id.* at 429.

242. *Id.* at 430; see *Texas E. Transmission Corp.*, 579 F.2d at 564.

243. *Morrison Grain Co.*, 632 F.2d at 431 (referring to *Texas E. Transmission Co. v. Marine Office-Appleton & Cox Corp.*, 579 F.2d 561, 564 (10th Cir. 1978)).

*Canadian Indemnity Co.*²⁴⁴ Further, an insured can be aware that he or she faces a massive loss and hundreds of claims before the insured learns the cause of the problem. An insured with leaking underground gasoline tanks may know that he or she is responsible for massive groundwater pollution, and may face hundreds of lawsuits or claims as a result, before the insured knows the cause of the leaks. In such a case, the carrier could raise a successful loss in progress defense because the insured could not prove that the cause of the loss is fortuitous.²⁴⁵ Knowledge of the cause of a loss should not be the test for the loss in progress doctrine. Rather, it should be sufficient that the insured knows he or she faces a substantial loss, for which he or she is legally responsible.

D. The Advantages and Disadvantages of the Loss in Progress and Fortuity Doctrines

From the insurance carrier's point of view, the loss in progress doctrine is a particularly strong defense. First, where the doctrine is codified, as it is in California,²⁴⁶ Maryland²⁴⁷ and New York,²⁴⁸ it is an expression of public policy which overrides any contrary language in an individual insurance policy.²⁴⁹ Second, as an expression of public policy the doctrine applies to all insurance contracts,²⁵⁰ whether property insurance policies or liability policies based on "occurrence" or "claims made" forms.²⁵¹ Third, although the loss in progress doctrine is related to rules governing contract rescission, a carrier cannot be forced to waive the loss in progress defense.²⁵²

There are similarities between the rules governing rescission of insurance contracts and those governing the application of the loss in pro-

244. 224 Cal. App. 3d 86, 90-92, 274 Cal. Rptr. 20, 22-24 (1990).

245. See, e.g., *Gerrish Corp. v. Universal Underwriters Ins. Co.*, 754 F. Supp. 358, 360-61 (D. Vt. 1990) (leaking storage tanks under gas station caused damage without owner's knowledge).

246. CAL. INS. CODE §§ 22, 250 (West 1972).

247. MD. ANN. CODE art. 48A, § 2 (1957).

248. N.Y. INS. LAW § 1101(a)(1) (McKinney 1985).

249. *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 1395-96, 253 Cal. Rptr. 277, 281-82 (1988).

250. *Presley v. National Flood Insurers Ass'n*, 399 F. Supp. 1242, 1244 (E.D. Mo. 1975).

251. *United States v. Conservation Chem. Co.*, 653 F. Supp. 152, 182-84 (W.D. Mo. 1986); *Fireman's Fund Ins. Co. v. Aetna Casualty & Sur. Co.*, 223 Cal. App. 3d 1621, 1627, 273 Cal. Rptr. 431, 433-34 (1990). An occurrence policy insures against the "occurrence" of covered injury during the policy term; a "claims made" policy insures against a covered claim being made during the policy term. *Pacific Employers Ins. Co. v. Superior Court*, 221 Cal. App. 3d 1348, 1357-59, 270 Cal. Rptr. 779, 783-84 (1990); *Gulf Ins. Co. v. Dolan, Fertig & Curtis*, 433 So. 2d 512, 514 (Fla. 1983).

252. See *New Castle County v. Hartford Accident & Indem. Co.*, 685 F. Supp. 1321, 1328-29 (D. Del. 1988).

gress doctrine. Under the rules governing rescission, nearly all states require an insured to disclose all material facts in applying for an insurance policy.²⁵³ A material fact is one which would lead the insurer either not to write a policy or to charge a higher premium.²⁵⁴ If the insured does not disclose material facts, the carrier can rescind the policy.²⁵⁵ The carrier need not prove that the insured acted fraudulently, intentionally or even negligently.²⁵⁶

The loss in progress doctrine is based on many of these same principles. The loss in progress doctrine precludes coverage when an insured has knowledge of a loss before a policy is issued.²⁵⁷ The insured's obligation to reveal material facts in applying for coverage requires him to disclose this loss or face possible rescission of the policy.²⁵⁸

Rescission under the loss in progress doctrine differs from typical insurance contract rescission in one significant sense: a carrier can be forced to waive the typical rescission defense.²⁵⁹ Failure of the carrier to conduct a thorough and prompt underwriting investigation before issuing a policy can lead to an implied waiver of its right to rescind when rescission would otherwise be justified by facts which a reasonably thorough investigation would have revealed.²⁶⁰ In some states this rule has been codified.²⁶¹ Unlike rescission, however, no statute requires waiver of a loss in progress defense in these circumstances. As such, there is a strong presumption against waiver.²⁶²

The great weakness in the loss in progress doctrine is that it applies

253. *E.g.*, CAL. INS. CODE § 331 (West 1972); N.Y. INS. LAW § 3105 (McKinney 1985); TEXAS INS. CODE ANN. § 21.16 (West 1981).

254. *Shapiro v. American Home Assurance Co.*, 584 F. Supp. 1245, 1249 (D. Mass. 1984) (applying Massachusetts law); *Old Line Life Ins. Co. v. Superior Court*, 229 Cal. App. 3d 1600, 1603-06, 281 Cal. Rptr. 15, 17-19 (1991); *Geer v. Union Mut. Life Ins. Co.*, 7 N.E.2d 125, 127 (N.Y. 1937).

255. *Thompson v. Occidental Life Ins. Co.*, 9 Cal. 3d 904, 916, 513 P.2d 353, 360, 109 Cal. Rptr. 473, 480 (1973).

256. *Id.*; *Hatch v. Woodmen Accident & Life Co.*, 409 N.E.2d 540, 543 (Ill. App. Ct. 1980); *Modisette v. Foundation Reserve Ins. Co.*, 427 P.2d 21, 25 (N.M. 1967).

257. *Chu v. Canadian Indem. Co.*, 224 Cal. App. 3d 86, 96-98, 274 Cal. Rptr. 20, 26-29 (1990).

258. *Thompson*, 9 Cal. 3d at 916, 513 P.2d at 360, 109 Cal. Rptr. at 480.

259. *Cora Pub, Inc. v. Continental Casualty Co.*, 619 F.2d 482, 487 (5th Cir. 1980) (applying Florida law); *Rutherford v. Prudential Ins. Co.*, 234 Cal. App. 2d 719, 733-34, 44 Cal. Rptr. 697, 705-06 (1965).

260. *Cora Pub, Inc.*, 619 F.2d at 487; *Rutherford*, 234 Cal. App. 2d at 733-34, 44 Cal. Rptr. at 705-06. *But see* *New Castle County v. Hartford Accident & Indem. Co.*, 685 F. Supp. 1321, 1328-29 (D. Del. 1988) (applying Delaware law) (holding insurer's failure to conduct thorough underwriting investigation did not waive its right to rescind based on insured's misrepresentation, but did make burden of proving misrepresentation more difficult).

261. *See, e.g.*, CAL. INS. CODE § 334 (West 1991).

262. *New Castle County*, 685 F. Supp. at 1328-29.

only if the insured knows of a loss *at the time the policy is issued*. If the insured acquires actual knowledge of a loss after the policy becomes effective, he or she may yet have coverage.²⁶³ The reason for this is basic: if the insured is unaware of a loss at the time a policy is issued, because he or she was negligent, the loss remains contingent or unknown. Coverage of the loss is consistent with the basic principle of insurance.²⁶⁴

In addition, because insureds have a reasonable expectation they will have coverage for their negligent conduct, the loss in progress doctrine should not preclude coverage when an insured is unaware of a loss at the time a policy is issued because he or she was negligent in not conducting an investigation.²⁶⁵ For example, the owner of underground storage tanks sometimes has the duty under a statute or administrative regulation to inspect those tanks periodically to determine if they might have leaks.²⁶⁶ An actual inspection might well reveal leaks. But the insured's failure to inspect, although negligent, means he or she remains ignorant of the leaks.²⁶⁷ Curiously, the doctrine of loss in progress precludes coverage for the insured who is vigilant and becomes aware of a loss, but allows coverage for the insured who is not.²⁶⁸

263. *Standard Structural Steel v. Bethlehem Steel Corp.*, 597 F. Supp. 164, 193 (D. Conn. 1984).

264. *See id.* (holding insurance contract valid if neither party knew of certain loss when contract made); RESTATEMENT (SECOND) OF CONTRACTS § 379 cmt. a (1981); RESTATEMENT OF CONTRACTS § 291 cmt. a (1932).

265. *See Texas E. Transmission Co. v. Marine Office-Appleton & Cox Corp.*, 579 F.2d 561, 565 (10th Cir. 1978) (applying Kansas law); *Chu v. Canadian Indem. Co.*, 224 Cal. App. 3d 86, 98-100, 274 Cal. Rptr. 20, 28-29 (1990).

266. *See, e.g., ALA. CODE* § 22-36-3(1)(f) (1990); *CAL. HEALTH & SAFETY CODE* § 25283.5(c) (West 1984 & Supp. 1991); *IOWA CODE ANN.* § 479.4 (1989).

267. *See, e.g., New Castle County v. Hartford Accident & Indem. Co.*, 685 F. Supp. 1321 (D. Del. 1988). The insured, a county government, diligently checked reported leaks from its landfills, eventually discovering significant groundwater contamination. As a result, the insured lost coverage under several policies issued after it had completed the inspections. *Id.* at 1330. Had the insured remained ignorant, it might have fared better.

268. Of course, an insured may face other coverage problems if he or she is unaware of a loss at the time a policy is issued but commits intentional acts later. For example, an insured may become aware of defects in a product only after a policy becomes effective and yet do nothing about them. In that event, post-notice conduct is intentional. *See, e.g., Hogan v. Midland Nat'l Ins. Co.*, 3 Cal. 3d 553, 560-61, 476 P.2d 825, 828-29, 91 Cal. Rptr. 153, 156-57 (1970).

Most CGL policies do not cover intentional conduct resulting in a loss. Typically, these policies require that a claim against the insured arise out of an occurrence which is usually defined as "an accident, including, continuous or repeated exposure to conditions, which results in bodily injury or property damage." *Commercial Union Ins. Co. v. Superior Court*, 196 Cal. App. 3d 1205, 1207, 242 Cal. Rptr. 454, 454 (1987) (emphasis added; emphasis in original removed) (quoting petitioner's policy). Courts have focused on the word "accident" in holding that CGL policies do not cover intentional conduct such as fraud, *Royal Globe Ins. Co. v. Whitaker*, 181 Cal. App. 3d 532, 534-55, 226 Cal. Rptr. 435, 437-38 (1986), or termina-

III. CONCLUSION

As the courts are presented with increasing numbers of progressive loss claims arising out of asbestos, pollution, soil subsidence and similar cases, the search for the boundaries of insurance coverage will intensify. Both insureds and insurers will demand that the courts tell them who must pay for these claims. Many years of insurance coverage may be involved in each case and litigation over which policies apply will rival the size and complexity of the liability claims themselves.²⁶⁹

The significance of the loss in progress doctrine is not that it tells us when coverage begins, but that it determines when it ends. Once the loss in progress doctrine terminates coverage for a particular claim, the insured cannot seek coverage under subsequent policies. Fixing the date for the loss in progress may mean millions of dollars in coverage or may force the insured into bankruptcy.

Because the loss in progress doctrine can have such grave consequences, it should be applied carefully. Only the insured's actual knowledge of a loss, as opposed to the constructive knowledge of a reasonable insured, should terminate coverage. An objective test for knowledge of the loss could prevent the insured from claiming coverage for his or her own negligence, when coverage for loss due to one's own negligence is a primary goal of modern liability insurance. Nothing short of a subjective test of one's actual knowledge justifies violating an insured's reasonable expectation of coverage.²⁷⁰

An insured should not lose coverage because he or she knows of

tion of an employee, *Dyer v. Northbrook Property & Casualty Ins. Co.*, 210 Cal. App. 3d 1540, 1548, 259 Cal. Rptr. 298, 303 (1989); *John's Cocktail Lounge, Inc. v. North River Ins. Co.*, 563 A.2d 473, 476-77 (N.J. Super. Ct. App. Div. 1989); *Mary & Alice Ford Nursing Home Co. v. Fireman's Ins. Co.*, 446 N.Y.S.2d 599, 600-01 (App. Div.), *aff'd*, 439 N.E.2d 883 (N.Y. 1982).

If, however, a policy's definition of occurrence uses a word other than, or in addition to, the word "accident," the insured may have a reasonable expectation of coverage for intentional conduct. Such words can include "event" or "happening." *See, e.g., United Pac. Ins. Co. v. First Interstate Bancsystems*, 664 F. Supp. 1390, 1393-94 (D. Mont. 1987) (applying Montana law); *United Pac. Ins. Co. v. McGuire Co.*, 229 Cal. App. 3d 1560, 1564-66, 281 Cal. Rptr. 375, 378-79 (1991); *First Newton Nat'l Bank v. General Casualty Co.*, 426 N.W.2d 618, 625 (Iowa 1988). *But see E-Z Loader Boat Trailers, Inc. v. Travelers Indemnity Co.*, 726 P.2d 439, 441-42 (Wash. 1986) (en banc) (holding that umbrella policy defining occurrence as "an accident or happening" did not cover intentional discrimination).

269. *E.g., Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982). In that case 19 years of policies were at issue. *Id.* at 1038. The policies took up several volumes of the record on appeal and 12 law firms were involved in the appeal. *Id.* at 1037, 1039 n.6. In *Insurance Co. of North America v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212 (6th Cir. 1980), *cert. denied*, 454 U.S. 1109 (1981), the court was compelled to construe policies issued over a 23-year period. *Id.* at 1227-28.

270. *See supra* notes 155-57 and accompanying text.

possible or actual claims made by injured third parties. Requiring the insured to know of possible or actual claims would encourage potential insureds to minimize reported losses in applying for insurance. Such a requirement would also encourage insurers to underwrite questionable risks. Furthermore, an insured purchases coverage as protection against the insured's own negligence. This expectation should be protected when the insured does not know of actual claims due to his or her own negligence.²⁷¹

The insured should also not lose coverage under the loss in progress defense simply because the insured does not know the extent of damage or injury resulting from a loss.²⁷² The insured may not learn the effects of injury or damage until long after lawsuits have been filed or even until they face trial. Such a narrow reading would encourage insureds to understate the extent of losses on insurance applications and claim coverage for undisclosed damage or injury.²⁷³ Additionally, this standard would result in insurers taking underwriting risks in order to generate premium revenue without full and complete knowledge of the extent of a potential risk.²⁷⁴

Nor should the insured be required to know the cause of a loss.²⁷⁵ The insured may not discover the cause of a loss until well into trial. Because an insured can be exposed to liability without knowing the source of an underlying problem, it is illogical to require that the insured determine the source in order to defeat a loss in progress claim. A contrary result would provide insurers with a windfall with the insurers knowing full well that their insureds would not be covered although the insureds had already paid premiums for this coverage. It should be enough that an insured knows that it faces a substantial loss for which it may be legally responsible.

271. See *supra* note 51 and accompanying text.

272. See *supra* notes 188-91 and accompanying text.

273. See *supra* notes 188-89 and accompanying text.

274. See *supra* notes 190-91 and accompanying text.

275. See *supra* notes 244-45 and accompanying text.

